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No. 84-1076

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Appellant,

v.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI and COASTAL EXPLORATION, INC., *et al.*,
Appellees.

On Appeal from the Supreme Court of Mississippi

APPELLANT'S REPLY BRIEF

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APPELLANT'S REPLY BRIEF

I. PREEMPTION

A. The Arguments Against Preemption are Fatally Flawed

Transco's opponents all assume that the *Natural Gas Act* (NGA) jurisdiction of the Federal Energy Regulatory Commission (FERC) over *wellhead sales* is the only federal regulation affected by Mississippi's Rule 48. Therefore, they argue there is no longer federal preemption of Mississippi's selective ratable purchase requirement on high cost gas, since Section 601(a)(1) of the Natural Gas Policy Act (NGPA) has eliminated FERC's NGA jurisdiction over high cost gas wellhead sales. There are at least three reasons why this approach must fail.

1. Partial Wellhead Deregulation under the NGPA has not created a regulatory gap which Congress intended the states to enter.

The NGPA was passed expressly to complement and supplement the NGA. It is an integral part of the federal scheme of regulation over the natural gas industry. This new federal scheme was designed for the same purpose as the NGA: to protect the consumer by assuring adequate supplies of gas at reasonable rates. *See* Note, *The Legislative History of the NGPA: Title I,* 59 Tex. L. Rev. 101, 123-24 (1980). The NGPA contains a carefully designed, phased deregulation of specific wellhead prices as part of a modification and expansion of the existing federal regulatory scheme.[1] It would be inconsistent with the Congressional purpose to permit the states to regulate what Congress has determined should not be regulated.[2] *Arkansas Louisiana Gas Co.* v. *Hall,* 435 U.S. 571, 580 (1981).

As its title suggests, Section 601 of the NGPA is designed to establish a guideline as to which of the two *federal* acts governs FERC's regulation of natural gas sold or transported in interstate commerce and the "natural gas companies" selling or transporting that gas. There is nothing in this provision, the Conference Report, or the legislative

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[1] One cannot ignore the fact that Congress created this complex new federal scheme rather than just deregulate natural gas. No gas has been "completely" or "totally" deregulated as has been asserted. Even today, before any first sales of gas can be considered both exempt from NGA jurisdiction and price "deregulated" under NGPA § 121 or § 601(a)(1), producers must complete the eligibility determination process required under NGPA § 503. 18 C.F.R. pt. 272; *Pennzoil* v. *FERC,* 645 F.2d 360, 381-82 (5th Cir. 1981). *See also* NGPA §§ 313, 314 and 315 for continuing federal regulation of first sales of so-called "deregulated" gas.

[2] Similarly, the 1975 Amendment to the Emergency Petroleum Allocation Act (EPAA), 15 U.S.C. §§ 751-760(h) represented an affirmative federal decision that certain oil prices be set by the free market, subject only to standby federal controls. This affirmative federal decision was held to preempt any state attempt to directly regulate those decontrolled oil sales. *Mobil Oil Corp.* v. *Dubno,* 492 F. Supp. 1004 (D. Conn. 1980), *appeal dismissed in part and aff'd in part,* 639 F.2d 919 (2nd Cir.), *cert. denied,* 452 U.S. 967 (1981).

history which suggests that Section 601 was intended to change the historic dividing line between federal and state jurisdiction over natural gas in interstate commerce. The fact that Section 601 prevented the FERC's *NGA* jurisdiction from expanding to certain new wellhead sales certainly does not translate into the withdrawal of all *federal* jurisdiction and a regulatory gap into which the states may now intrude.

2. Section 601(a)(1) has not affected interstate pipeline regulation.

The specific issue in this case is whether a state can force an interstate pipeline to purchase gas it otherwise would not purchase or regulate the terms of that purchase. Section 601(a)(1) does nothing to limit the exclusivity of FERC's NGA jurisdiction over interstate pipelines. However, Section 601(a)(1) does affect FERC's NGA jurisdiction over certain producer wellhead sales. The critical phrase is "solely by reason of" found in Section 601(a)(1)(A), (B) and (D).

Under *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954), an independent producer was considered to be a "natural gas company" and regulated under the NGA only when it *sold* gas for transportation and resale in interstate commerce. Under the NGPA, when a producer sells high cost gas to an interstate pipeline, that producer is no longer personally subject to NGA jurisdiction because NGA jurisdiction was "solely by reason of" the wellhead sale.[3]

On the other hand, Transco, as an interstate pipeline, purchases gas for transportation and sale in interstate commerce. FERC's NGA jurisdiction over Transco's operations is not "solely by reason of" the first sale and is indeed totally unrelated to the first sale. It is clear that FERC's NGA jurisdiction over Transco is not at all affected

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[3] Of course the seller (and the natural gas sold by him) cannot be exempt from both NGA and NGPA price jurisdiction unless and until that gas is finally determined to be "deregulated" under both Sections 121 and 601(a) of the NGPA. *See supra* note 2.

by Section 601(a)(1). Under the federal regulatory scheme, the cost of gas and the cost of service of interstate pipelines are reflected in rates charged to the consumer. There is no indication that Congress intended the states to have control over any of these and other functions which directly affect the interstate consumer.[4] This is FERC's exclusive domain.

The legislative history of the NGPA clearly indicates that Congress intended, in certain instances, to relieve *producers* from the NGA utility-type regulations.[5] Congress did not intend to relieve the pipelines from comprehensive federal regulation.[6]

3. A pipeline's purchase cannot be regulated by the state without conflicting with FERC's regulation of interstate transportation and sales.

Coastal and Getty both maintain that the outcome of *Northern Natural Gas Co.* v. *State Corporation Commission*, 372 U.S. 84 (1963), was the result of NGA jurisdiction over wellhead sales and the right of the Federal Power

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[4] The standard under which FERC regulates an interstate pipeline's purchased gas costs has been modified by Section 601(c) which expressly addresses the intricate relationship between the pipelines' cost structures and the eventual cost of their wholesale customers. However, even Transco's opponents do not claim that Section 601(c) creates any regulatory gap for the states to occupy.

[5] *See* Appellant's Brief (App. Br.) at 12-13; "Curtis/Jackson letter" of September 8, 1978, FPAS NGPA Inf. Serv. § 601:220, pp. 3-4.

[6] In two articles, cited numerous times by the Mississippi Supreme Court and Appellees herein, Professor Pierce concludes that "deregulation" by the NGPA was limited to producers and not the pipelines. *See* Pierce, *Natural Gas Regulation, Deregulation, and Contracts*, 68 Va. L. Rev. 63, 86-90 (1982) (hereinafter Pierce I); Pierce, *Reconsidering the Roles of Regulation and Competition in the Natural Gas Industry*, 97 Harv. L. Rev. 345, 348-50 (1983) (hereinafter Pierce II). Because of the many market distortions created by pipeline regulation and because of significant changes in the pipelines' position in the gas market since 1938, he suggests that the existing *"pervasive regulation of gas pipelines as public utilities should be replaced by a less intrusive form of regulation . . . ."* Pierce II, at 384 (emphasis added).

Commission (FPC), at that time, to set wellhead prices and require certificates of public convenience and necessity from producers before the gas could be sold. However, *Northern Natural* was not premised on whether there was a contract or whether the gas was certificated and it involved no wellhead price issue.[7] Furthermore, this contention is contrary to the express language in the majority opinion. Mr. Justice Brennan made it perfectly clear that the conflict which required pre-emption did not involve wellhead sales. The conflict involved the pipeline's cost structures and the extent to which any regulation thereof by a state would inevitably impact on the FPC's jurisdiction over transportation and sale in interstate commerce. Today the "intricate relationship" between a pipeline's cost structure and its resales rates is even more critical because of the wide disparity among wellhead prices after deregulation, in addition to unprecedented take-or-pay problems.

Getty and Coastal proceed to argue that Section 601(a)(1) of the NGPA has now separated a pipeline's purchase of natural gas from its operation of facilities, transportation, and resale of that gas, all admittedly still regulated by FERC under the NGA. As "proof" of this contention, they assert that certificates of public convenience and abandonment approval under NGA § 7 are no longer required for first sales of gas qualifying under Section 601(a)(1)(A) or (B). However, this begs the question. Just like *Northern Natural,* there is no issue of producer certificates or abandonment in this case.

Mississippi is requiring Transco to purchase high cost gas it otherwise would not purchase on "reasonable terms, including a reasonable price, determined by reference to prevailing market conditions and other economic consid-

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[7] 372 U.S. at 86-7. In *Northern Natural,* the FPC took the position that the only interference the Kansas order created was the affect of take-or-pay payments on resales costs if the pipeline followed the state order rather than the dictates of its long term gas purchase contracts. 372 U.S. at 96, 99 n.1.

erations."[8] These are direct gas purchase costs which, absent fraud, abuse or other similar grounds, must be passed through to Transco's resales customers.[9] One cannot ignore the conflict that this ratable take order will have with FERC's current ongoing examination of pipelines' purchasing practices to determine whether such practices are in accord with a "fundamental duty to provide service at the lowest reasonable rate consistent with maintenance of adequate service [to customers or consumers]."[10] Clearly, there would be a direct conflict if FERC were to determine that Transco should not purchase the very supplies of non-contract gas that Transco is purchasing in order to comply with Rule 48.[11] FERC Br. at 21-22.

Mississippi's action is no less an intrusion than the Louisiana First Use Tax which was declared preempted by the NGA and NGPA in *Maryland* v. *Louisiana*, 451 U.S. 724 (1981). It interferes more with FERC's jurisdiction than

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[8] Jurisdictional Statement (J.S.) App. A at 55a. Presumably what is reasonable with reference to the prevailing market conditions and other economic considerations will be determined by the State Oil and Gas Board. The court further stated that the Board's attempt to fix prices at a higher level was not unconstitutional; it merely had not been sanctioned by the Mississippi legislature.

[9] Section 601(c)(2), 15 U.S.C. § 3431(c)(2).

[10] *Columbia Gas Transmission Corp.*, 26 FERC ¶ 61,034, ¶ 61,105-106, *appeal docketed sub. nom., Office of Consumers' Counsel* v. *FERC*, No. 84-1099 (D.C. Cir., March 16, 1984). *See Transcontinental Gas Pipe Line Corp.*, 26 FERC ¶ 61,362 (1984) (setting Transco's purchasing practices for hearing).

[11] This issue is presently before the Commission in Transco's current PGA proceedings. *See* Assoc. Gas Dist. Br. at 13-15. On August 16, 1985, the FERC staff filed a brief which argued:

> Mississippi Rule 48, which requires Transco to take gas ratably from all wells in a common pool, prevents Transco from pursuing a least cost purchasing strategy and results in higher costs to ultimate consumers in violation of sections 4 and 5 of the NGA.
>
> The Commission should exercise its exclusive jurisdiction over Transco's purchasing practices and direct Transco to pursue a least cost purchasing strategy irrespective of Rule 48.

Initial Brief of Commission Staff, *Transcontinental Gas Pipe Line Corp.*, Docket Nos. TA 85-1-29 and TA 85-3-29, at p. 7 (August 16, 1985).

the Alabama severance tax pass-through prohibition this Court preempted with respect to sales made to interstate pipelines. *Exxon* v. *Eagerton*, 462 U.S. 176 (1983).

Another analogous case is *FPC* v. *Louisiana Power and Light Co.*, 406 U.S. 621 (1972) (hereinafter *LP&L*). In *LP&L*, this Court determined whether the FPC, during the national gas shortage, could direct a pipeline to curtail its direct sales to industrial customers. *LP&L* argued, under Section 1(b) of the NGA, that such direct sales to industrial customers were expressly exempted from any FPC jurisdiction. The Court noted:

> In a borderline case where congressional authority is not explicit, we must ask whether state authority can practicably regulate a given area and, if we find that it cannot, then we are impelled to decide that federal authority governs.

406 U.S. at 631. In 1972, 37% of the pipeline's sales were direct sales to industrial customers. The Court concluded that the states would not effectively regulate those direct sales without creating a "seriously inequitable system of gas distribution" nationwide, stating:

> The conflicting results would necessarily produce allocations determined simply by the ability of each [direct sale] customer to pump its desired volume from a pipeline. . . . Besides a state agency empowered to regulate these contracts would be obliged to regulate in the State, not the national interest. . . . The unavoidable conflict between producing States and consuming States will create contradictory regulations that cannot possibly be equitably resolved by the courts. With these problems in mind, the desirability of uniform federal regulation is abundantly clear.

Id. at 633-35. The Court went on to determine that the FPC did have authority to require curtailment of these direct sales through its broad NGA transportation jurisdiction. *Id.* at 636-41.

This case presents practical problems which are analogous to the problems faced in *LP&L*. Instead of facing a gas shortage and curtailment of deliveries, consumers are

today faced with the irony of rising gas costs despite low demand and a surplus of gas. Producers now claim that FERC only has jurisdiction over gas that is still price regulated at the wellhead, with no control over a pipeline's purchase of deregulated gas.[12] Producing states, facing a producer constituency and lower severance tax revenues, will necessarily regulate in the state, not the national interest.[13] If the states are allowed to regulate pipeline purchases of the deregulated gas, the inevitable result will be a kaleidoscopic variation of regulatory schemes, each with its unique impact on the ability of FERC to ensure adequate gas supplies and service at just and reasonable rates in the interstate gas market.[14] The necessity for uniform federal regulation is as abundantly clear in today's market as it was in the gas shortage facing the Court in *LP&L. Id.* at 635-36.

B. The Preemption Cases Dealing With Other Federal Legislation Have No Precedential Value.

Several recent preemption cases dealing with entirely different legislation have been cited for the proposition that, absent express preemption or direct conflict, the Court should not readily infer preemption just because of complex federal legislation.[15] However, the holding of these

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[12] As of January 1, 1985, additional categories of gas were price deregulated. 15 U.S.C. § 3331. Estimates place the volume of this price deregulated gas at over 50% of the nation's production. Pendley, *Blueprint: Partial Deregulation of Natural Gas,* A.B.A. Nat. Resources and Env't, Spr. 1985 at 25.

[13] The Board's action in this case is a perfect example of a state's predisposition to maximize its own gas sales. The Board's duty and authority is limited to protecting correlative rights among *producers* and promoting production at its maximum efficient rate. It had no duty or inclination to consider the pipeline's market and economic problems or to protect consumers in other states. *See* Joint Appendix (J.A.) at 165, 169, 237-38.

[14] Compare Mississippi regulation with the market demand oriented programs of Texas and Oklahoma. *See,* Getty Br., App. A; Texas Br., p. 9; J.S. App. I.

[15] *See,* Getty Br. at 22-24; Miss. Brief at 6; Coastal Br. at 39-40. Coastal has also cited *Energy Reserves Group Inc.* v. *Kansas Power and Light Co.,* 459 U.S. 400 (1983) as "a NGPA case". However, this case

cases have absolutely no precedential value as to determination of congressional intent behind the NGA and NGPA. Moreover, these cases are not even helpful by analogy because of an important distinction in the historical regulation of the transactions at issue in each of the cases. Critical to all but one of these cases is that both the area and the specific transaction or entity over which federal jurisdiction was asserted had historically been regulated by the states.[16] On the other hand, purchases by an interstate pipeline have historically been beyond the scope of state regulation.[17] Thus, since the transaction at issue in this case is within the historic "federal zone", the presumption is in favor of preemption, absent "clear congressional consent" by Congress.[18]

Section 602(a) of the NGPA is the only manifestation of any intent by Congress to cede to the states any Commerce Clause power. However, Rule 48 does not, in any way, comport with what is allowed by Section 602. App. Br. at 45-46.[19]

Arkansas Electric Cooperative Corp. v. *Arkansas Public Service Commission*, 461 U.S. 375 (1983), relied on by

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dealt with a state statute which applied only to *intrastate* sales; no preemption issue was involved.

[16] *Hillsborough County* v. *Automated Medical Laboratories, Inc.*, 105 S. Ct. 2371, 2376 (1985) (licensing of blood plasma center); *Metropolitan Life Insurance Co.* v. *Massachusetts*, 105 S. Ct. 2380, 2398-99 (1985) (mandated benefits in health insurance contracts); *Pacific Gas & Electric Co.* v. *State Energy Resources Conservation & Development*, 461 U.S. 190, 194-195 (1985) (generation of electrical power).

However, in other recent cases state laws were preempted despite the fact that the area was traditionally regulated by the states. *See, e.g., Allis Chalmers Corp.* v. *Lueck*, 105 S. Ct. 1904 (1985) (common law tort action for bad faith handling of insurance claim preempted by Labor Management Relations Act.); *Philko Aviation Inc.* v. *Shacket*, 462 U.S. 406 (1983) (Federal Aviation Act preempts state personal property recordation law.).

[17] *See Interstate Natural Gas Co.* v. *FPC*, 331 U.S. 682 (1947); *Missouri* v. *Kansas Gas Co.*, 265 U.S. 298 (1924).

[18] *See Montana* v. *Blackfeet Tribe of Indians*, 105 S. Ct. 2399 (1985).

[19] The Mississippi Supreme Court agrees. *See* J.S. App. A at 51a.

Appellees was a preemption case comparing federal jurisdiction under the Federal Power Act of 1938 and the Rural Electrification Act of 1936 with the Arkansas Public Service Commission's attempt to establish wholesale rates charged by the Arkansas Electric Cooperative Corporation (AECC) to its member-retail distributors who were located within the state of Arkansas. The Court began its preemption analysis by noting:

> If AECC were not a rural power cooperative, the wholesale rates it charges to its members would, under the scheme we described in Part I [The Federal Power Act] supra, be subject exclusively to federal regulation. . . . In 1967, however, the FPC held that it had no jurisdiction under the Federal Power Act to regulate wholesale rates charged by rural power cooperatives under the supervision of the REA. Dairyland Power Cooperative, 37 FPC 12, 67 PUR 3rd 340.

461 U.S. at 381-82. The Court further stated:

> Were the FPC or the courts ever definitively to overrule *Dairyland* and decide that the FPC did have jurisdiction, we would obviously be faced with a very different preemption question.

461 U.S. at 383, n.7.

FERC's active regulation of Transco is sweeping in scope and leaves no room for state intervention.[20]

II. COMMERCE CLAUSE

A. The "Practical Effect" of Rule 48 is to Both Burden and Discriminate Against Interstate Commerce.

The replies of both Getty and Coastal spring from the mistaken assumption that Rule 48 is the only revelant factor to be considered under the Commerce Clause. From that false

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[20] *See* App. Br. at 14-16. On May 30, 1985, 50 Fed. Reg. 24130 (1985), FERC issued a Notice of Proposed Rulemaking, setting forth what can only be described as radical and sweeping changes to its regulation of interstate pipelines. One aspect of this proposed regulation is a new billing mechanism under which pipelines would be required to allocate purchases of low priced "old" gas for the benefit of their existing sales customers.

premise, they proceed to argue that Rule 48 is not unconstitutional because it does not expressly require either the taking of additional gas or the imposition of take-or-pay obligations. Coastal Br. at 44-46, Getty Br. at 31-32.

However, Transco has never represented to this Court that Rule 48, standing alone, violated the Commerce Clause. Rather, Transco has consistently examined the "practical effect" of Rule 48.[21] The practical effect in this case arises from the confluence of four factors—the excess supply and low demand for gas, long term contracts nationwide which contain take-or-pay provisions based upon a high percentage of deliverability, Mississippi's practice of regulating without regard to market demand, and Rule 48. It is the confluence of these factors, not Rule 48 alone, which increases the consumer price of natural gas and discriminates against other producing states. J.S. at 15-19, App. Br. at 38-46. Transco has thoroughly documented the existence of these factors and correctly portrayed their combined result.

Nevertheless, challenges have been made to the factual support for this practical effect.[22] However, the existence of a gas surplus is so clear cut that the Board Chairman volunteered that it could be stipulated at the hearing before the Board. J.A. at 158. Legal Found. Br. at 9, n.16. Further, Transco proffered evidence that, as early as May of 1982, its resales markets were insufficient to consume all of the gas tendered for delivery under Transco's contracts.[23]

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[21] J.S. at 15-20, App. Br. at 37-40. As noted therein, this Court examines a state law not in a vacuum but in its necessary operation in the real world. This examination necessarily includes the regulatory environment and the customary business relationships, in this case, the existence of long term contracts with high percentage take-or-pay provisions. *See* Pierce I *supra* n.6, at 77-82 and 92-99. Appellees do not disagree that this "practical effect" must be examined, they simply ignore it in this case.

[22] Coastal Br. at 15 and 44, Getty Br. at 31-32 and 36; National Gov. Ass'n Br. at 19.

[23] J.A. at 163-64. This evidence had to be proffered because it was considered irrelevant by the Board. J.A. at 156.

Coastal criticizes Transco for arguing that Rule 48 is unconstitutional under "present market conditions." Coastal Br. at 45-46. Of course this

Since Transco cannot currently resell all of the gas it has under contract, it cannot make any additional purchases of gas required by Rule 48 without displacing contract gas.[24] The result of not taking this gas under contract is to incur additional take-or-pay claims which will inevitably drive up the price of gas to the consumer.[25] However, the Board refused to even admit evidence of the interstate implications of its acts. J.A. at 164-65 and 169.

As to high percentage take-or-pay contracts, Getty admits that in contracts negotiated from 1970 to 1981 the sellers were generally able to demand and receive high percentage take-or-pay provisions. Getty Br. at 35. An *amicus curiae* has admitted that contracts of this type were "characteristic of the natural gas industry." Nat'l Gov. Ass'n Br. at 5. The commentator cited most by Appellees notes that high percentage take-or-pay provisions were not only commonplace in gas contracts but also were caused primarily by the "interaction of . . . distortional [FERC] regulatory mechanisms." *Pierce II supra* n.6, at 369-370; *see also Pierce I supra* n.6, at 92. Long term contracts with take-or-pay provisions have been a part of the regulatory scheme since its inception. To suggest that contract provisions can be ignored because they are "private contracts" is to suggest that the Court ignore the entire marketplace for natural gas.

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case is based upon present market conditions; there is no need to enforce ratable take regulations except during a gas glut. During the shortages from the late 1960s through 1981, the market was greater than available production. Therefore, every pipeline was willing to take all gas tendered to it. Only since production has exceeded demand has ratable taking become an issue. Since present market conditions are necessary to provoke enforcement of Rule 48, it is improper for Coastal to suggest that those same conditions be ignored when Rule 48 is challenged.

[24] J.A. at 169. Since the Mississippi courts refused to stay enforcement of Rule 48 pending appeal, these adverse consequences are currently occurring.

[25] J.A. at 164-65. An additional result is to discriminate against other states by increasing Mississippi's market share. J.A. at 170; App. Br. at 38-46.

Getty correctly notes that gas contracts usually contain a provision which allows "make up" of gas for which take-or-pay prepayments have been made. Getty Br. at 30. However, interstate burdens are not thereby obviated. First, even if take-or-pay is ultimately recovered, it results in a current charge to the customer. Second, make up rights in this case are an illusion. The applicable make up period is five years. In order to take advantage of any make up rights, however, Transco's resales markets would have to expand to the point where Transco could not only sell all contractual commitments, but also additional volumes sufficient to make up for past deficiencies. Even Getty concedes that the current market surplus is projected to last until 1990. Getty Br. at 30-31. Under Getty's own forecast, take-or-pay obligations incurred from 1982-85 could not be recouped from producers and will be forever lost.

B. The Interests of Fairness are Not Promoted by Rule 48.

One argument which appears throughout the Respondents' briefs is that Rule 48 is designed to promote "fairness" by giving certain Mississippi oil and gas investors a right to sell gas. Indeed, the Mississippi Supreme Court cites "fairness" as the legitimate local interest which supports Rule 48. J.S. at 34a-35a.

However, attempts to justify Mississippi's regulation as essential to fairness and the prevention of drainage are unsupported by the record. Both Coastal and Getty give the impression that there was ratable production and taking from the six wells in question prior to July 1, 1982, when Transco, due to its inability to market its gas already under contract, first refused to take gas it was not contractually required to take. Coastal Br. at 11; Getty Br. at 6-7. However, a comparison of actual production with the established well allowables for the six wells at issue reveals that two of the wells operated by Getty were producing gas in *excess* of their state allowables [26] and one producing well operated

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[26] A comparison of production figures for April-June, 1982, J.A. at 10-11, with well allowables for the same period, J.A. at 241-42, reveals that

by Florida Exploration had not even been granted an allowable.[27] The producers' geological and engineering witnesses also admitted that these wells were producing unratably and drainage was occurring *before* Transco made any requests to reduce takes. J.A. at 17-19, 95-96.

Mississippi has the statutory policy of encouraging production at maximum efficient rates of flow. Miss. Code Ann. § 53-1-1 (1972). In 1982, the Board's approach to this goal was no production regulation at all.[28] Therefore, the Rule of Capture flourished in Mississippi, unabated and unrestricted by considerations of "preventing waste" or "fairness."

Further, Mississippi's approach to "fairness" ignores the interests of three very important groups—consumers of natural gas, other producing states and interstate pipelines.

At one end of the pipeline is the ultimate consumer of natural gas. The consumer may be an individual homeowner which must purchase gas for heating purposes or it may be a large industry which has the flexibility to switch to alternate fuels depending on price. To these consumers, "fairness" means adequate supplies of gas at the lowest possible price.

At the other end of the pipeline are producers of natural gas such as Getty and Coastal. Getty is typical of those producers which secured contracts with a pipeline for the sale of natural gas prior to the decline in the market. These contracts bear a very high price and also very high percentage take-or-pay obligations. To Getty, therefore, "fair-

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the Getty-Rogers well produced 104.6% of its allowable and the Getty-Buckley produced 143.8% of its allowable. Meanwhile, the two other wells with allowables were producing only 55% and 62% of those allowables. *Id.*

[27] *Compare* J.A. at 10-11 *with* J.A. at 241-242. Under Mississippi law the Florida Exploration wells without allowables should not have been producing at all. Miss. Code Ann. § 53-3-9(b) (1972).

[28] It is apparent from the State Oil and Gas Board's "allowable order", Transco General Exhibit B, that the Board was setting allowables for every gas well in the state at whatever the operator reported the well capable of producing, without regard to any other conservation factor.

ness'' is the continuing sale of gas at high prices or the collection of high take-or-pay payments under its contracts in order to maximize the return on its investment.

The other class of producers is represented by Coastal. These producers did not commit their gas in order to secure long term gas purchase contracts with pipelines. To Coastal, therefore, ''fairness'' is to have the state assure it of a ready market for its gas.[29]

Also involved in the ''fairness'' question are other producing states. Mississippi's approach is certainly unfair to those states whose total production is reduced because of this discrimination. *See* J. S. at 21-22, App. Br. at 40-42. This will be particularly distasteful to states like Texas and Oklahoma which limit production to market demand. *See* J.S. App. H and I; Getty Br., App. A.

Caught in the middle of these competing interests are the interstate pipelines. Their ''profit'' is not based upon gas prices because purchased gas costs are, subject to NGPA

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[29] Of course, Coastal did have other sales opportunities available to it. Coastal's observation that Transco is denying it market access by some monopolistic control over the "wellhead market" in these two gas fields is contradicted by the record. Coastal Br. at 7. Despite the Board's declaration of irrelevance, the record clearly shows that another pipeline was actively competing with Transco in these fields, was building separate facilities, and had a significant amount of the gas not being taken under long-term contracts. J.A. at 128, J.S. App. A. at 15a. It is further undisputed that Transco had offered to buy the gas at market price and subsequently had offered every non-contract owner in these wells access to its facilities for transportation to any other purchaser. J.A. at 66-73.

Furthermore, direct consumer/producer sales on the spot market now account for a significant portion of the total natural gas wellhead sales within the United States. *FERC's Proposed Rulemaking: Accelerating the Spot Market,* Natural Gas 18 (Sept. 1985). *See also,* Dutton, *Marketing Opportunities for Producers,* Natural Gas 7 (June 1985); Means, *The Viability of Direct Producer Sales,* Natural Gas 6 (April 1985); Keagle, *Natural Gas Purchases: The End-user Viewpoint,* Natural Gas 13 (July 1985); Wilson, *Natural Gas Market: Competition Heats Up,* U.S.A. Today, December 7, 1984, at 4b, col. 1. Coastal acknowledges that, as of March 1985, only 9 of the 36 purchasers of natural gas from Mississippi were interstate pipelines. *See,* Coastal Br. at 7, n.7.

Section 601(c)(2), passed through directly to those consumers willing to buy. Transco's return on its investment is governed totally by FERC, which regulates so as to assure just and reasonable rates to the consumer. To Transco, therefore "fairness" lies in being allowed to purchase gas and perform service in accord with the dictates of its market and federal regulation, which are not currently consistent with Rule 48.

It is clear that "fairness" means different things to different people. It is equally clear that Mississippi has not and cannot balance all the relevant interests that deserve "fairness." Mississippi has simply made a choice which favors its producer constituents at the clear expense of the pipelines, other states, and the consumer.

The Mississippi Supreme Court justifies placing the burden on the consumer of natural gas by stating that the NGPA contemplated and approved increases in the consumer price of gas.[30] Certainly the NGPA did try to correct a severe market shortage by increasing financial incentives for the exploration and production of natural gas. The necessary evil attendant with this approach was an increase in the consumer price of natural gas. However, the NGPA goal of adequate supplies of natural gas has been long since realized. Therefore, the other federal goal—gas at reasonable prices—now comes into play. Mississippi's action clearly frustrates this goal; therefore Mississippi cannot justify treating the consumer unfairly by saying it is sanctioned by the NGPA.

Mississippi's approach to "fairness" violates the Commerce Clause as well as the goals of the NGPA. Because

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[30] J.S. App. A at 35a-36a and 37a-38a. This argument that the NGPA somehow sanctions price increases to the consumer was also adopted by Appellees, Miss. Br. at 15, and Getty Br. at 35-36. Getty even suggests that consumers should be "appreciative" of these higher prices because of the production thereby encouraged. *Id.* at 29 and 35. However, the simple fact is that there is currently an excess of production. No legitimate interest can be served by further excesses. The public is not buying this high priced gas, much less "appreciating" it.

the consumers of natural gas are part of interstate commerce, they are protected from such unfair treatment. However, the production of natural gas is not part of interstate commerce. *Northern Natural,* 372 U.S. at 94. Thus, Mississippi can legally prorate *production* and require its producers with contracts to share their markets with producers without contracts. Getty objects to this approach because proration will reduce its sales and deprive it of the right to seek take-or-pay payments on gas which it is not allowed to produce. However, if the State desires to give all of its producers fair access to a limited market, the only way to constitutionally achieve that desire is to reduce the allowable, and thereby reduce the unbalanced access of those producers in the field with contracts.

C. *Peerless* Does Not Support Rule 48.

Appellees have consistently cited *Cities Service Gas Co.* v. *Peerless Oil & Gas Co.*, 340 U.S. 179 (1950) (hereinafter *Peerless*), as support for the proposition that all ratable take regulations are approved under the Commerce Clause. However, *Peerless* is cited for its result only; the Appellees have unfortunately ignored its reasoning.

The inapplicability of *Peerless* has been discussed at length elsewhere and need not be repeated herein. J.S. at 22-24; App. Br. at 44-45. Suffice it to say that *Peerless* stands only for the proposition that state actions which result in insignificant price increases can be constitutional.[31] No pre-

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[31] Getty tries to force this case under *Peerless* by claiming that the price impact of Rule 48 is insignificant because of the small quantities of deregulated gas in 1981. Getty Br. at 30-31. By 1982, however, deregulated gas had reached 7% of the national gas market. Because of the high price differential between this gas and other gas, even this modest amount created a significant impact upon the average cost of gas for each pipeline. J.S. at 24, n.26.

Getty also ignores the fact that wellhead sales of much of § 102 and § 103 gas were price deregulated as of January 1, 1985. 15 U.S.C. § 3331 (a). Thus the category of gas to which the Mississippi Supreme Court's decision applies, J.S. at 29a, has grown from 7% to 50% of the total market. "Deregulated" gas constitutes a constitutionally significant portion of today's gas market.

emption issue was raised nor did the Court consider the significant price increases and discrimination involved in this case.[32]

D. Valid Regulatory Alternatives Do Exist.

In previous briefs, Transco has outlined a less burdensome regulatory alternative which is both effective and clearly constitutional—market proration. J. S. at 20-21, App. Br. at 46-48.

Getty now claims that proration will not work because it does not give a market to noncontract producers. However, the limitation of each producer to his pro rata share of market demand is only the first step. The second step is for the state or the well operator to allocate the production allowed by the available market to all producers on an equitable basis.[33] Tc the extent that a producer is legally precluded from producing gas, it should not be able to seek to enforce take or take-or-pay obligations in excess of those limits. Once these obligations in excess of market demand are eliminated, and the production is prorated among all producers, then no adverse impact will result to the interstate consumer. *See Northern Natural,* 372 U.S. at 98-99 (Harlan, J. dissenting). Likewise, this system avoids interstate discrimination because it recognizes that the total market is limited and restricts the state's production to its fair share of that market. In *Northern Natural,* this Court approved the alternative as an effective and constitutional

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[32] Further, since the pipeline, unlike Transco, was also the major producer, 340 U.S. at 180, *Peerless* involved the state's unquestioned authority to regulate production. *Id.* at 186.

[33] Getty argues that would not be effective because the pipelines control the flow rate of the wells. Getty Br. at 36-37. Again, one can look to the record in this case for contradiction. Here, Transco was taking the gas in question from a facility built and operated by Getty. It was Getty, the well operator, that produced each well and determined how producers in each well were to be paid for that gas. J.A. at 115 and 131-32.

means of achieving the state's purposes of protecting correlative rights.[34] *Id.* at 94, n.12.

On the other hand, Coastal objects to market proration on the ground that first, it is prohibited by Mississippi law and second, it may result in greater burdens than Rule 48. Coastal Br. at 46-49. It is true that the Board believes a Mississippi statute prohibits it from considering market demand and setting well allowables.[35] *See* Miss. Code Ann. § 53-1-1 (1972) and J.A. 93-95. However, it makes no differance whether the offending enactment is a Board regulation or a Mississippi statute. In either event, burdensome laws must fall before the Commerce Clause. If Mississippi desires to grant a market to producers like Coastal, it can change its statutory scheme as necessary to allow the Board to regulate in a constitutional manner.

Coastal's second objection is based upon the dissent of Justice Harlan in *Northern Natural.* However, nowhere does the dissent suggest that a market proration system during an oversupply of gas will result in greater costs. Indeed, Justice Harlan observes that if take-or-pay obligations are relieved, then the net effect may be an actual decrease in the price of gas. 372 U.S. at 98, 105.

Transco does agree that a proration system will place greater administrative burdens on the Board. *Id.* at 100-101. However, the majority in *Northern Natural* felt that these burdens should be borne by state regulatory agencies, not

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[34] With respect to the so called drainage phenomenon referred to by the Mississippi Supreme Court and Appellees, the drainage of reserves from one well to another can be remedied effectively by the state setting lower production allowables for wells causing drainage until correlative rights in the common reservoir are balanced. Similarly, the suggested practice of requiring a well operator to share the market by allocating production among all co-owners would remedy any production imbalances between contract and non-contract producers in a common well.

[35] However, that statute further provides that the limitation is "subject to the prevention of waste." *Id.* Indeed, for many years prior to 1978, Mississippi established gas allowables on the basis of market demand nominations by pipelines. *See* Appendices C and D to Appellant's Rebuttal Brief before the Mississippi Supreme Court.

shifted to the shoulders of the interstate pipeline companies. *Id.* at 92.

Mississippi states that the legitimate local interest supporting Rule 48 is "fairness." However, that particular interest can be adequately served by producer regulations which do not burden the interstate market. Mississippi's regulation in this case intrudes into interstate commerce further than is necessary to achieve its stated objective, serves no legitimate interest, is "unfair" and is therefore unconstitutional.

CONCLUSION

The decision of the Mississippi Supreme Court should be reversed.

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